13.1.2 TSX Request for Comments - Amendments to Part VI of the TSX Company Manual

TORONTO STOCK EXCHANGE

REQUEST FOR COMMENTS

AMENDMENTS TO PART VI OF THE TORONTO STOCK EXCHANGE ("TSX") COMPANY MANUAL

TSX is publishing proposed changes to Part VI – *Changes in Capital Structure of Listed Issuers*, of the Manual (the "Amendments"). The Amendments are being published for a 30 day comment period.

The Amendments will be effective upon approval by the Ontario Securities Commission (the "OSC") following public notice and comment. Comments should be in writing and delivered by **Monday February 26, 2007** to:

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A copy should also be provided to the:

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Comments will be publicly available unless confidentiality is requested.

Overview

TSX is seeking comments on the Amendments. Various changes to Part VI went into effect on January 1, 2005. Since that time, our experience with the application of the rules has indicated that certain provisions in Part VI could either be clarified or improved, due to both the benefit of time and practice, and in response to the changing needs of our stakeholders. The objective of the Amendments is for TSX to continue to provide listed issuers with a complete and transparent set of TSX standards and practices allowing issuers and investors, and their respective advisors, to have certainty when planning and completing transactions.

The Amendments are focused on certain provisions of Part VI of the Manual, as summarized below.

Part VI – *Changes in Capital Structure of Listed Issuers*:

Interlisted Issuer Exemption – Subsection 602(g)

Subsection 602(g) provides express exemptions to various rules in the Manual where the issuer is listed on another exchange and at least 75% of the trading value and volume over the six months immediately preceding notification occurs on that other exchange. The issuer must provide TSX with written notice under Section 602, at which time TSX will notify the issuer of its eligibility under Subsection 602(g) and TSX's conditions of acceptance of the transaction. The exemptions are currently for rules relating to security holder approval (Section 604), private placements (Section 607), unlisted warrants (Section 608) and security based compensation arrangements (Section 613). TSX is proposing to add an exemption from the acquisition requirements under Section 611.

The interlisted issuer exemption was created to address conflicts between exchange requirements for issuers listed on more than one exchange, and went into effect on January 1, 2005. The exemption was created in deference to the exchange on which the issuer's trading principally occurred. The exemption aims to minimize rule duplication and conflicts, as well as to provide transparency to market participants when interlisted issuers contemplate transactions enumerated in Subsection 602(g). However, as previously stated in the Request for Comments published in the January 2, 2004 OSC Bulletin and the Approval of Amendments published in the November 5, 2004 OSC Bulletin, TSX understands that certain other markets (including Nasdaq and the New York Stock Exchange) provide certain exemptions to listed issuers based on the jurisdiction of incorporation, regardless of whether or not such market is the principal market for the issuer. In those cases, the listed issuer would be able to choose whether or not to apply for an exemption to TSX rules.

TSX has received several inquiries by interlisted issuers about the availability of this exemption for acquisitions. Staff believe it is appropriate and consistent with the original intent of the exemption to add relief from acquisition requirements contained in Section 611 of the Manual, and consider the omission of Section 611 from the application of Subsection 602(g) as an oversight at the time the rules were drafted.

Question 1: Is relief from the acquisition requirements contained in Section 611 appropriate for interlisted issuers where at least 75% of the trading value and volume occurs on another exchange? If not, why?

<u>Unlisted Warrants – Section 608</u>

Historically, TSX has not required the value of warrants to be factored into the allowable pricing discount levels for private placements contained in Subsection 607(e) mainly due to the difficulty in establishing a value for such warrants. Current TSX rules provide that, without security holder approval, the exercise price of warrants may not be less than the market price of the listed securities (Subsection 608(a)) at the time an agreement is entered into to issue the warrants. This results in the warrants having no immediate intrinsic value. Some concerns have been raised by market participants regarding the potential inconsistency of having pricing requirements (i.e. allowable discounts) for securities distributed by private placements without factoring in a value for warrants.

Prior to January 1, 2005, TSX practice for private placements was to allow no more than one "sweetener" to insiders and generally no more than two "sweeteners" to non-insiders. "Sweeteners" included, among other things, discounts to market price, flow through tax credits and warrants. Private placements which had been negotiated at arm's length with more than one "sweetener" were particularly problematic as insiders participating in the transaction were restricted from participating on the same basis, despite, in some cases, a relatively small subscription. The restriction existed in order to minimize the benefits to insiders under private placements. Effective January 1, 2005, TSX discontinued this practice and replaced it with a specific requirement for disinterested security holder approval for dilution to insiders exceeding 10% of issued and outstanding listed securities within any six month period (Subsection 607(g)(ii)). This new approach was intended to provide some restrictions on insiders receiving excessive benefits under private placements, but focusing on dilution rather than the number of sweeteners.

Since January 1, 2005, TSX has received a number of applications from listed issuers for private placements of units (i.e. one common share and one warrant) priced at a discount, a portion of which is subscribed for by insiders. Provided that less than 10% of the issued and outstanding listed securities are issuable to insiders (among other things), security holder approval is not currently required. However, under such private placements, the addition of a warrant, without factoring in its value into the subscription price is, in effect, providing subscribers with a discount in excess of TSX's available discounts.

For example, a listed issuer proposes a private placement of 1,000 units, each unit consisting of one common share and one common share purchase warrant (one common share purchase warrant can purchase one common share at a price of $20.00 for a period of five years from the date of issuance), and the issuer's listed common shares have a market price of $20.00. The unit is being sold at $17.00 per unit, which is the market price less the maximum allowable discount (15% for securities with a market price above $2.00). Provided that insiders are not receiving more than 10% of issued and outstanding securities over the last six months (among other things), security holder approval would not be required.

In this example, assuming the warrants were valued at $5.00 per warrant, the net subscription price of the shares would be $12.00 per share, resulting in a 40% discount, well beyond the allowable discount.

The Black-Scholes model for valuing warrants and options is the most frequently used valuation method for financial reporting purposes. There are also other models to value warrants, options and other derivative instruments, such as lattice models. However, some market participants argue that warrant and option pricing models are flawed, and that models such as Black-Scholes are arbitrary and should therefore not be used.

At this time, we are not proposing a valuation requirement or method to establish the value of unlisted warrants under Section 608. However, we would like to obtain comments as to whether a valuation requirement should be introduced, and if so, what type of valuation model should be adopted.

Question 2: Should TSX establish a standard valuation calculation for warrants and factor such valuation into allowable discounts for private placements? Should the Black-Scholes model be used or an alternative methodology? Under the Black-Scholes model, what should be the appropriate period for the volatility (or beta) calculation?

Question 3: If yes to Question 2 above, what impact if any should there be to other "sweeteners" such as flow-through tax credits?

Security Based Compensation Arrangements & Insiders – Subsections 613(a), (h) and (i)

Subsection 613(a):

TSX is proposing to delete the word "aggregate" in Subsection 613(a) within the insider limitations for security based compensation arrangements ("arrangements" or "plans"). The deletion of the word is intended to clarify that the provision contains two separate requirements for insider limitations and was not originally intended to be aggregated. This is consistent with guidance we have provided to issuers in the past. This language has been a source of confusion for issuers and their counsel, and TSX wants to take this opportunity to provide more clarity on this requirement.

TSX policies provide that all plans must be approved by security holders when adopted and, in certain instances, when amended. Limits to insider participation are used to determine whether security holder approval will be based on the votes of all voting security holders or excluding the votes of insiders entitled to participate in the plan.

The annual limit (subparagraph i) and the ongoing limit (subparagraph ii) should be calculated separately, and not in the aggregate. These two requirements are distinct concepts and TSX is therefore proposing to remove the word "aggregate" to address any confusion relating to this matter. The policy intention of this requirement was to ensure that there was a bright line restriction on the number of securities issued to insiders (within any one year), as well as issuable to insiders at any time. Calculating the insider limits separately, rather than in the aggregate, is the most appropriate protection to limit insider participation without disinterested security holder approval.

Subsections 613(h) & (i):

TSX is also proposing to add specific security holder approval requirements in Subsection 613(i) for listed issuers who want to:

- change the limits to insider participation within a plan;
- change the fixed maximum number or percentage of securities issuable pursuant to a plan;
- add a cashless exercise provision for plans without a fixed maximum number where a full deduction of underlying securities may not be made; or
- change the amendment provisions of a plan.

Notwithstanding that a plan contains provisions allowing the board of directors to make these changes without obtaining security holder approval, TSX will require the issuer to obtain specific security holder approval each time such an amendment is proposed. We believe that the amendments described above constitute fundamental changes to a plan and that it would be inappropriate to permit these changes under a broad amendment provision without security holder approval in each case.

s. 613(h)(ii) Prohibited Provisions Notwithstanding Security Holder Approval:

The additional language in s. 613(h)(ii) has been added to confirm that, while a plan must provide a fixed maximum number or percentage, the actual number or percentage cannot be amended without security holder approval. This was always the intent behind this provision and reflects current practice, although the rule did not clearly state this in the past.

s. 613(i)(i)-(ii) Changing the exercise price or terms of options held by insiders:

This currently exists under s. 613(h)(iii) and has not changed, other than being moved from s. 613(h)(iii) and split into two separate provisions.

s. 613(i)(iii) Changing limits to insider participation in a plan:

Should issuers be permitted to amend limits to insider participation without security holder approval, this could provide a way for issuers to deliberately circumvent disinterested security holder approval and provide insiders with unlimited participation in a plan. This would allow issuers to do indirectly what they cannot do directly under Subsection 613(a).

s. 613(i)(iv) Changing the fixed maximum of a plan:

A change to the fixed maximum number or percentage of securities issuable under a plan is a fundamental change to the plan as it may affect the number of securities issued under a plan. Security holders should be given an opportunity to vote on any changes which may affect overall dilution. Therefore, any change to the maximum number or percentage of securities issuable under a plan should be approved by security holders.

s. 613(i)(v) Adding a cashless exercise provision to plans without a fixed maximum number where a full deduction of underlying securities may not be made:

Generally, upon application, TSX has permitted the addition of a cashless exercise provision to a plan without security holder approval where a full deduction of the underlying securities was made because it was viewed as economically neutral to the issuer.

In the context of a plan with a fixed maximum number of securities issuable, the issuer not only would appear to be in an economically equivalent position whether the securities were exercised for cash or on a cashless exercise basis, but the issuer would also be required to return to security holders for approval to increase the number of securities issuable under the plan at the same time if a full deduction of the underlying securities was made. Generally, a cashless exercise which does not provide for the full deduction of the reserve would prolong the life of the number of securities reserved for issuance for the purposes of a plan.

Since the implementation of the rule changes on January 1, 2005 (which permitted rolling or evergreen plans), TSX has not permitted cashless exercises for evergreen plans without security holder approval because a full deduction of the underlying securities could not be made. Evergreen plans may be reconstituted without security holder approval and security holder approval is only required every three years pursuant to Section 613(a).

Evergreen plans are primarily affected by the addition of a cashless exercise feature because a deduction of securities cannot be made, nor does it result in issuers returning to security holders for approval on an accelerated basis as it does for a fixed maximum number plan which provides for a full deduction. TSX is therefore proposing to require security holder approval for the addition of any cashless exercise feature which does not provide for a full deduction of the underlying securities, or where such a deduction cannot be made such as in the case of an evergreen plan.

When options are exercised on a cash basis, the option holder pays the full exercise price for the options and, the issuer then issues securities underlying the options to such option holder. The number of securities reserved for issuance for the purposes of the plan will then be reduced by the number of securities issued to the option holder. A cashless exercise allows an option holder to receive such number of securities that is equal in value to the difference between the market price of the underlying securities and the exercise price of the option. When the plan does not require the reserve to be fully deducted, only the actual number of securities issued to the option holder would be deducted from the reserve. A full deduction of the reserve would be one that would be done as if the options had been exercised on a cash basis, rather than on a cashless basis. An example of a cashless exercise follows below.

Example: An option holder has 100 options, each option exercisable at $10.00 for one share and the current market price of the shares is $20.00. A normal exercise for cash would require the payment of $10.00 per share. Assuming the exercise of all of the 100 options, this results in:

- aggregate proceeds to the company of $1,000 (100 options x $10)
- 100 shares being issued from the treasury of the company
- assuming the option holder sells the securities, net proceeds of $1,000 for the option holder (100 shares sold x $20 market price, less $1,000 to exercise the options)

Under a cashless exercise the option holder does not pay any cash to exercise the option. Instead, in exchange for the cancellation of the options the option holder receives 50 shares upon the exercise of his 100 options. The shares issuable on a cashless exercise are calculated as follows:

$$\text{Number of shares issued (50)} = \frac{[\text{Market Price (\$20)} - \text{Exercise Price (\$10)}] \times \text{No. of Options (100)}}{\text{Market Price (\$20)}}$$

Assuming the exercise of all of the 100 options, this results in:

- no cash proceeds to the company
- 50 shares being issued from the treasury of the company
- assuming the option holder sells the securities, net proceeds of $1,000 for the option holder (50 shares sold x $20 market price)

Another form of cashless exercise is one which does not result in the issuance of any shares by the company but rather the payment of the "in the money" amount of the options. In this example that amount would be $1,000 assuming all 100 options were exercised. This amount is calculated by the numerator of the above formula.

s. 613(i)(vi) Changing the amendment provisions of a plan:

Current TSX rules contemplate that any amendment to a plan requires security holder approval, unless the plan contains specific provisions to the effect that the board of directors (or similar body) can amend such provision without security holder approval. Given the fact that security holders must approve which aspects of the plan the board of directors may amend without their approval, any changes to the amendment provision in a plan should also be approved by security holders.

Question 4: Consider whether it is appropriate to require specific security holder approval for each of the instances described above.

Public Interest

TSX is publishing the Amendments for a 30 day comment period, which expires **Monday February 26, 2007**. TSX believes that it is important for its key stakeholders to have an opportunity to review the Amendments prior to their implementation. As a result, the Amendments will only become effective following public notice, a comment period and the approval of the OSC.

Text of Amendments

The Amendments are attached as **Appendix A.**

APPENDIX A

REQUEST FOR COMMENTS FOR AMENDMENTS TO PART VI

The TSX Company Manual (the "Manual") is proposed to be amended as follows:

1. Subsection 602(g) will be amended as follows:

   (g) TSX will not apply its standards with respect to security holder approval (Section 604), private placements (Section 607), unlisted warrants (Section 608), acquisitions (Section 611) and security based compensation arrangements (Section 613) to issuers listed on another exchange where at least 75% of the trading value and volume over the six months immediately preceding notification occurs on that other exchange. These issuers must still comply with Section 602, at which time TSX will notify the issuer of their eligibility under this Subsection 602(g) and the documents and fees required for TSX acceptance of the notified transaction.

2. Section 613 will be amended as follows:

   (a) When instituted, and when required for amendment, all security based compensation arrangements must be approved by:

      i) a majority of the listed issuer's directors; and

      ii) subject to Subsections 613(b), (c), (g) and (j~~i~~), by the listed issuer's security holders.

   Every three years after institution, all unallocated options, rights or other entitlements under a security based compensation arrangement which does not have a fixed maximum aggregate of securities issuable, must be approved by:

      i) a majority of the listed issuer's directors; and

      ii) subject to Subsections 613(b), (c), (g) and (j~~i~~), the listed issuer's security holders.

   Insiders of the listed issuer entitled to receive a benefit under the arrangement are not eligible to vote their securities in respect of the approvals required by this Subsection 613(a) unless the ~~aggregate~~ number of the listed issuer's securities:

      i) issued to insiders of the listed issuer, within any one year period, and

      ii) issuable to insiders of the listed issuer, at any time,

   under the arrangement, or when combined with all of the listed issuer's other security based compensation arrangements, could not exceed 10% of the listed issuer's total issued and outstanding securities, respectively.

   If any security holder approval is required for a security based compensation arrangement and insiders of the listed issuer entitled to receive a benefit under the arrangement are not eligible to vote their securities in respect of the approval required by this Subsection 613(a), holders of Restricted Securities, as defined in Part I, must be entitled to vote with the holders of any class of securities of the listed issuer which otherwise carry greater voting rights, on a basis proportionate to their respective residual equity interests in the listed issuer.

   Security holder approval required for a security based compensation arrangement must be by way of a duly called meeting. The exemption from security holder approval contained in Subsection 604(e) is not available in respect of security based compensation arrangements.

   Types of Security Based Compensation Arrangements

   (b) For the purposes of this Section 613, security based compensation arrangements include;

      i) stock option plans for the benefit of employees, insiders, service providers or any one of such groups;

      ii) individual stock options granted to employees, service providers or insiders if not granted pursuant to a plan previously approved by the listed issuer's security holders;

iii) stock purchase plans where the listed issuer provides financial assistance or where the listed issuer matches the whole or a portion of the securities being purchased;

iv) stock appreciation rights involving issuances of securities from treasury;

v) any other compensation or incentive mechanism involving the issuance or potential issuances of securities of the listed issuer; and

vi) security purchases from treasury by an employee, insider or service provider which is financially assisted by the listed issuer by any means whatsoever.

For greater certainty, arrangements which do not involve the issuance from treasury or potential issuance from treasury of securities of the listed issuer are not security based compensation arrangements for the purposes of this Section 613.

For the purposes of Section 613, a “service provider” is a person or company engaged by the listed issuer to provide services for an initial, renewable or extended period of twelve months or more.

Exception to the Requirement for Security Holder Approval – Employment Inducements

(c) Security holder approval is not required for security based compensation arrangements used as an inducement to a person or company not previously employed by and not previously an insider of the listed issuer, to enter into a contract of full time employment as an officer of the listed issuer, provided that the securities issuable to such person or company do not exceed 2% of the number of securities of the listed issuer which are outstanding, on a non-diluted basis, prior to the date of the arrangement.

Disclosure Required when Seeking Security Holder Approval & Annually

(d) Materials provided to security holders in respect of a meeting at which the approval of security based compensation arrangements will be requested must be pre-cleared with TSX. Such materials must provide disclosure, as of the date of the materials, in respect of:

i) the eligible participants under the arrangement;

ii) each of the following, as applicable:

i. the total number of securities issued and issuable under each arrangement and the percentage of the listed issuer’s currently outstanding capital represented by such securities,

ii. the total number of securities issued and issuable under each arrangement, as a percentage of the listed issuer’s currently outstanding capital, and

iii. the total number of securities issuable under actual grants or awards made and the percentage of the listed issuer’s currently outstanding capital represented by such securities;

iii) the maximum percentage, if any, of securities under each arrangement available to insiders of the listed issuer;

iv) the maximum number of securities, if any, any one person or company is entitled to receive under each arrangement and the percentage of the listed issuer’s currently outstanding capital represented by these securities;

v) subject to Section 6l3(h)(i), the method of determining the exercise price for securities under each arrangement;

vi) the method of determining the purchase price for securities under security purchase arrangements, with specific disclosure as to whether the purchase price could be below the market price of the securities;

vii) the formula for calculating market appreciation of stock appreciation rights;

viii) the ability for the listed issuer to transform a stock option into a stock appreciation right involving an issuance of securities from treasury;

ix) the vesting of stock options;

x) the term of stock options;

xi) the causes of cessation of entitlement under each arrangement, including the effect of an employee's termination for or without cause;

xii) the assignability of security based compensation arrangements benefits and the conditions for such assignability;

xiii) the procedure for amending each arrangement, including specific disclosure as to whether security holder approval is required for amendments;

xiv) any financial assistance provided by the listed issuer to participants under each arrangement to facilitate the purchase of securities under the arrangement, including the terms of such assistance;

xv) entitlements under each arrangement previously granted but subject to ratification by security holders; and

xvi) such other material information as may be reasonably required by a security holder to approve the arrangements.

Should a security based compensation arrangement not provide for the procedure for amending the arrangement, security holder approval will be required for such amendments, as provided for in Subsection 613(a). In addition, the votes attaching to any securities held by insiders who hold securities subject to the amendment will be excluded. Please see Subsection 613 (l~~k~~) for more information.

Granting Entitlements Prior to Seeking Security Holder Approval

(e) A listed issuer may grant options or rights under a security based compensation arrangement that has not been approved by security holders provided that no exercise of such option or right may occur until security holder approval is obtained.

Filing Security Based Compensation Arrangements with TSX

(f) All security based compensation plans, and any amendments thereto, must be filed with TSX, along with evidence of security holder approval where required. Listed securities issuable under the arrangements will not be listed on TSX until such documentation is received.

Annual Disclosure Requirements

(g) Listed issuers must disclose on an annual basis, in their information circulars, or other annual disclosure document distributed to all security holders, the terms of their security based compensation arrangements and any amendments that were adopted in the last fiscal year (this includes amendments to individual security agreements and amendments to security based compensation arrangements, including, in both instances, those assumed by the listed issuer through an acquisition). The information circular must provide disclosure in respect of each of the items in Section 613(d), as of the date of the circular, as well as the nature of the amendments adopted in the last fiscal year, including whether or not (and if not, why not) security holder approval was obtained for the amendment.

Prohibited Provisions ~~or Amendments~~ Notwithstanding Security Holder Approval

(h) Notwithstanding that a security based compensation arrangement ~~has~~ contains provisions: (1) contrary to or inconsistent with the following items, or (2) allowing amendments to the following items without security holder approval, and that such provisions have been approved by the listed issuer's security holders:

i) the exercise price for any stock options granted under a security based compensation arrangement or otherwise must not be lower than the market price of the securities at the time the option is granted; and

ii) the arrangement must have a maximum number of securities issuable, either as a fixed number or a fixed percentage of the listed issuer's outstanding capital represented by such securities, which may not be increased without specific security holder approval.~~; and (iii)~~

Amendments Requiring Specific Security Holder Approval in all Circumstances

(i) Notwithstanding that a security based compensation arrangement contains a provision allowing amendments to the following items without security holder approval, specific security holder approval (excluding the votes of securities held directly or indirectly by insiders benefiting from the amendment) is required for:

i) ~~(x)~~ a reduction in the exercise price or purchase price ~~or (y) an extension of the term,~~ under a security based compensation arrangement benefiting an insider of the issuer;

ii) an extension of the term, under a security based compensation arrangement benefiting an insider of the issuer;

iii) any amendment to increase the maximum limit of the number of securities that may be:

a. issued to insiders of the listed issuer within any one year period, or

b. issuable to insiders of the listed issuer, at any time;

under the arrangement, or when combined with all of the listed issuer's other security based compensation arrangements, which could exceed 10% of the listed issuer's total issued and outstanding securities, respectively;

iv) an increase to the maximum number of securities issuable, either as a fixed number or a fixed percentage of the listed issuer's outstanding capital represented by such securities;

v) for security based compensation arrangements that do not have a fixed maximum number of securities issuable, the addition of any provision that allows for the exercise of options without cash consideration, whether the option holder receives the intrinsic value in the form of securities from treasury or the intrinsic value in cash, and where a deduction may not be made for the number of securities originally underlying the options; and

vi) amendments to an amending provision within a security based compensation arrangement.

Reporting Requirements to TSX

~~(i)~~(j) The granting of stock options under a plan and the issuance of securities under a stock option plan or other plan do not require the prior consent of TSX if the plan has been precleared with TSX and the securities that are subject to issuance have been listed. However, stock options granted, exercised or cancelled under a plan must be reported to TSX on a monthly basis in the form of a duly completed Form I - Change in Outstanding and Reserved Securities (Appendix H: Company Reporting Forms). If no listed securities are issued, no options have expired or been cancelled in any particular month, a nil report is required to be filed on a quarterly basis.

Material Undisclosed Information

~~(j)~~(k) TSX's policy on timely disclosure requires immediate disclosure by its listed issuers of all "material information" as defined in the policy. The policy also recognizes that there are restricted circumstances where confidentiality may be justified on a temporary basis. Listed issuers may not set option exercise prices, or prices at which securities may otherwise be issued, on the basis of market prices which do not reflect material information of which management is aware but which has not been disclosed to the public. Exceptions are:

i) where employees, at a previous time when such employees did not have knowledge of the undisclosed event, committed themselves to acquire the securities on specified terms through participation in a security purchase plan, or

ii) where, in relation to an undisclosed event (such as the acquisition by a listed issuer of another issuer), a person or company who is neither an employee nor an insider of the listed issuer, is granted, or given the right to be granted at a set price, a stock option in the listed issuer, while the event is still undisclosed.

Amendment Procedures

~~(k)~~(l) Security based compensation arrangements cannot be amended without obtaining security holder approval unless the arrangement contains a provision empowering the listed issuer's board of directors (who may delegate this to a committee of the board) to make the specific amendment. Security holder approval is required for the introduction of and subsequent amendments to, such amending provisions. Disclosure provided to security holders voting on amending provisions, and annually, must state that security holder approval will not be required for amendments permitted by the provision.